

97-84058-22

U.S. Internal Revenue
Service

Income tax primer

Washington

1921

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BIBLIOGRAPHIC MICROFORM TARGET

ORIGINAL MATERIAL AS FILMED - EXISTING BIBLIOGRAPHIC RECORD

| | |
|---------|---|
| 308 | U. S. Internal Revenue Service. |
| Z | U. S. Office of internal revenue. |
| Box 155 | ... Income tax primer. Rev. January 1, 1921. Prepared by the Bureau of internal revenue for the information and assistance of taxpayers. Washington, Govt. print. off., 1921. |
| | 40 p. 24 $\frac{1}{2}$ cm. |
| | At head of title: Treasury department. United States internal revenue service. |
| | Volume of pamphlets |
| | 1. Income tax—U. S.—Law. 1. Title. |
| | Library of Congress |
| | Copy 2. |
| | HJ4652.A4 1921 |
| | 21-26064 |
| | i3j |
| | amvd |

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TECHNICAL MICROFORM DATA

FILM SIZE: 35mm

REDUCTION RATIO: 10:1

IMAGE PLACEMENT: IA IIA IB IIB

DATE FILMED: 3-28-97

INITIALS: ms

TRACKING # : 23049

FILMED BY PRESERVATION RESOURCES, BETHLEHEM, PA.

308
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TAX
TREASURY DEPARTMENT
UNITED STATES INTERNAL REVENUE SERVICE

INCOME TAX PRIMER

Box

Revised January 1, 1921

PREPARED BY THE BUREAU OF INTERNAL REVENUE
FOR
THE INFORMATION AND ASSISTANCE
OF TAXPAYERS



WASHINGTON
GOVERNMENT PRINTING OFFICE
1921

6618 1344-1924

INCOME TAX PRIMER.

Revised January 1, 1921.

RETURNS.

1. Am I required to render a personal income tax return for 1920?

Yes; if unmarried or if married and not living with husband or wife, and your net income for that year equals or exceeds \$1,000, or if you were married and living with husband or wife and your net income equals or exceeds \$2,000 for that year.

If you act as the guardian of a minor or incompetent person, or as the administrator, executor, or trustee of an estate or trust, a return will be required of you for and in behalf of your ward, or the estate or trust for which you act, if the conditions outlined under the head of "Fiduciaries," as requiring a return, are present in your case.

2. What is meant by the taxable year 1920?

The taxable year 1920 means the calendar year 1920 or any fiscal year ending during the calendar year 1920.

3. What does the term "fiscal year" mean?

The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December.

4. Upon what period of time shall my 1920 income tax return be based?

Your 1920 return should be rendered upon the basis of your annual accounting period (fiscal year or calendar year, as the case may be). If your annual accounting period is other than a fiscal year as defined above, or if you have no annual accounting period or do not keep books, you should render your return upon the basis of the calendar year.

5. May I change my accounting period for the purpose of rendering my income tax return?

Yes; if permission is secured from the Commissioner in accordance with Treasury Decision 3032 amending article 26 of Regulations 45. If a taxpayer, who has been rendering his return upon the basis of his accounting period, changes that accounting period, and wishes to change the basis of rendering his return to accord with his new accounting period, he shall as soon as possible give to the collector for transmission to the Commissioner written notice of such change and of his reasons therefor. The Commissioner will not approve a change of the basis of computing net income unless such notice is given at a time which is both (a) at least thirty days before the due date of the taxpayer's return on the basis of his existing taxable year and (b) at least thirty days before the due date of his separate return for the period between the close of the existing taxable year and the date designated as the close of the proposed tax-

able year. The due date of the separate return for such period is the fifteenth day of the third month following the close of that period. If the change in the basis of computing the net income of the taxpayer is approved by the Commissioner, the taxpayer shall thereafter make his returns upon the basis of the new accounting period in accordance with the requirements of section 226 of the statute and his net income shall be computed as therein provided.

The separate return referred to above is required under section 226 of the Revenue Act of 1918, which provides that if a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year. If a taxpayer making his first return for income tax keeps his accounts on the basis of a fiscal year he shall make a separate return for the period between the beginning of the calendar year in which such fiscal year ends and the end of such fiscal year.

In all of the above cases the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included; and the credits provided in subdivisions (c) and (d) of section 216 shall be reduced, respectively, to amounts which bear the same ratio to the full credits provided in such subdivisions as the number of months in such period bears to twelve months.

6. Where should my personal return for the year 1920 be filed?

Section 227(b) of the Revenue Act of 1918 provides that your return shall be filed with the collector of internal revenue for the district in which you have your legal residence or principal place of business. If your legal residence is located in one collection district and your principal place of business in another, it is optional with which collector your return shall be filed; but for administrative reasons the Commissioner of Internal Revenue desires that it be filed with the collector of the district in which your legal residence is located.

7. When may my 1920 return be filed with the collector of internal revenue?

If you make return on a calendar year basis, on any day after December 31, 1920, but not later than March 15, 1921. If you make your return on a fiscal year basis it must be filed not later than the 15th day of the third month following the close of the fiscal year.

8. May an extension of time beyond March 15, 1921, be obtained for the filing of my 1920 return?

Yes; if, on account of sickness or absence from home, you are unable to render your return within the time prescribed by law, you

may obtain an extension of thirty days if a request therefor is filed with the collector of your district. In this request you must state the reason why the return can not be filed within the time prescribed by law.

9. Would a personal return rendered by an agent, for and in my behalf, be accepted?

If by reason of illness, absence, or nonresidence a taxpayer is unable personally to render his return he may appoint an agent to act for him and the return executed by the agent will be accepted if he makes affidavit that he has sufficient knowledge to make a complete and accurate return for his principal. Such agent assumes responsibility for making the return, and incurs liability to the specific penalties provided for erroneous, false, or fraudulent returns.

10. May a husband and wife living together make separate returns?

Yes; they should in every case make separate returns where the wife has a separate income and the aggregate net income of both husband and wife is \$5,000 or over. Where the combined net income in excess of credits (see question 89)—that is, the combined net income subject to normal tax, is in excess of \$4,000 separate returns should be made in order that there will not be an overassessment of tax. Husband and wife living together are entitled to a personal exemption of not to exceed \$2,000 against their aggregate net income. If separate returns are made the personal exemption of \$2,000 may be taken by either or divided between them.

11. Is a married man who is entitled to a personal exemption of \$2,000 and \$400 additional exemption on account of two dependent children, and whose total net income does not exceed \$2,400, but does equal or exceed \$2,000, required to make a return?

Yes; although he is not required to pay an income tax, he is required to make a return.

12. Where can I get a blank form upon which to make my return?

From the collector of internal revenue for your district. The collector will endeavor to have such form sent to you, but failure to receive one will not excuse you from making a return. If you do not receive one, it is your duty to request one of the collector.

EXEMPTION.

13. What amount of personal exemption is allowed by the Revenue Act of 1918?

Section 216(c) of the Act allows a personal exemption of \$1,000, plus \$1,000 if the person making the return is the head of a family (see art. 302, Regulations 45) or a married man living with his wife. This additional exemption of \$1,000 is allowed if the person making the return is a married woman living with her husband, but in no event shall the combined personal exemption of a husband and wife living together, exclusive of credit for dependents, exceed \$2,000.

In addition, a further exemption of \$200 is allowed for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer, if such dependent person is under 18 years of age or is incapable of self-support because mentally or physically defective. (Sec. 216(d).)

14. A widower has a child over 18 years of age, whom he supports, who is away from home attending school. What personal exemption may be claimed by the widower who maintains the home?

He is entitled to claim a personal exemption of \$2,000 as head of a family, under section 216(c) of the Revenue Act of 1918.

15. What personal exemption may be claimed by a son who actually supports and maintains his dependent mother elsewhere than in his own home by reason of the fact that he is unable to earn enough to support both in the mother's place of abode or to defray their joint expenses in his place of employment?

The son is properly classifiable for income tax purposes as the head of a family and as such is entitled to claim a personal exemption of \$2,000.

16. I was not actually living with my wife on December 31, 1920, due to her mental incompetency at that time and consequent confinement in an institution for treatment. What personal exemption may I claim in my 1920 return?

The separation of a husband and wife due to the fact that either has been declared mentally incompetent and confined in an institution for treatment is held to be temporary in character and consequently without effect in so far as the joint personal exemption of \$2,000 is concerned.

17. In case both a husband and wife contribute to the support of a dependent, how is the credit of \$200 for dependents to be treated?

The credit of \$200 must be taken by the one contributing the chief support and may not be divided between them.

EXEMPT INCOME.

18. What income, if any, is exempt?

(a) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

(c) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income).

(d) Interest upon (1) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (2) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (3) the obligations of the United States or its possessions; or (4) bonds issued by the War Finance Corporation; except as follows: In the case of obligations of the United States issued after September 1, 1917, and in the case of bonds issued by the War Finance Corporation the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issuance thereof as amended and supplemented and shall be excluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer.

(e) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal

injuries or sickness, plus the amount of any damages received, whether by suit or agreement, on account of such injuries or sickness.

(f) So much of the amount received during the present war by a person in the military or naval forces of the United States as salary or compensation in any form from the United States for active services in such forces as does not exceed \$3,500.

(g) Compensation paid its officers and employees by a State or political subdivision thereof, including fees received by notaries public commissioned by States and the commissions of receivers appointed by State courts. Employees of universities receiving salaries paid in part or in whole from funds available under the Smith-Lever Act of May 8, 1914, who are officers or employees of a State, are not required to return as taxable income the salaries so received. This is also true with respect to the Act of August 30, 1890, relating to colleges for the benefit of agriculture and the mechanic arts, and to the Act of March 2, 1887, relating to agricultural experiment stations in such colleges.

19. To what extent is interest received in 1919 and subsequent years on Liberty bonds, Victory notes, United States Certificates of Indebtedness, and War Savings Certificates exempt from income tax?

All Liberty bonds, Victory notes, United States Certificates of Indebtedness, and War Savings Certificates are exempt both as to principal and interest from all Federal, State, and local taxation except (a) estate or inheritance taxes and (b) Federal income surtaxes, excess profits, and war profits taxes.

Interest on 3½ per cent Liberty bonds, 3½ per cent Victory notes, and United States Certificates of Indebtedness issued before September 1, 1917, is wholly exempt from normal tax, surtax, excess profits, and war profits taxes.

Interest on 4½ per cent Victory notes is wholly exempt from normal tax, but is subject to surtax, excess profits, and war profits taxes.

Liberty bonds, other than 3½ per cent Liberty bonds, United States Certificates of Indebtedness issued after September 1, 1917, and War Savings Certificates are entitled to certain limited exemptions from surtax, excess profits and war profits taxes in respect to the interest on principal amounts thereof as stated in the summary below.

Summary of Exemptions against Holdings of Liberty Bonds, United States Certificates of Indebtedness and War Savings Certificates, issued after September 1, 1917.

KEY TO SYMBOLS USED IN SUMMARY OF EXEMPTIONS ON TAXABLE LIBERTY BONDS.

- 1—First Liberty bond issue.
 - 2—Second Liberty bond issue.
 - 3—Third Liberty bond issue.
 - 4—Fourth Liberty issue.
 - 1-2—First Liberty bonds converted into Second Liberty bonds.
 - 1-3—First Liberty bonds converted into Third Liberty bonds.
 - 1-4—First Liberty bonds converted into Fourth Liberty bonds.
 - 2-3—Second Liberty bonds converted into Third Liberty bonds.
-

Applicable to 1917 and subsequent years during life of bonds and certificates.

| | | |
|----|---------|---|
| *A | \$5,000 | This exemption may be claimed once against any taxable Liberty bonds (not including Victory notes), converted or unconverted, United States Certificates of Indebtedness issued after Sept. 1, 1917, or War Saving Certificates or may be divided among them. |
|----|---------|---|

Applicable to 1918 and two years after the close of the war as fixed by proclamation of the President.

| | | |
|------------|----------|--|
| B | \$30,000 | Allowed to owner against 4, no matter how obtained. |
| **C *** | \$45,000 | This exemption (maximum \$45,000) is limited to 1½ times amount of 4 originally subscribed for by the taxpayer and still held by him at the time of filing the return and may be claimed against any one of 2, 3, 1-2, 1-3, or 2-3 or may be divided among them. |
| D | \$30,000 | Allowed against 1-4, no matter how obtained. |

Applicable to 1919 and five years after close of war as fixed by proclamation of the President.

| | | |
|---|----------|---|
| E | \$30,000 | This exemption may be claimed against any one of 2, 3, 4, 1-2, 1-3, 1-4, or 2-3 (regardless of any holdings of Victory notes) or may be divided among them. |
|---|----------|---|

Applicable to 1919 and during the life of the Victory notes (4 years).

| | | |
|------|----------|---|
| ***F | \$20,000 | This exemption (maximum \$20,000) is limited to three times the amount of Victory notes (either 3½ or 4½ originally subscribed for by the taxpayer and still held by him at the date of filing the return and may be claimed against any one of 2, 3, 4, 1-2, 1-3, 1-4, or 2-3) or may be divided among them. |
|------|----------|---|

\$160,000 maximum total exemption allowed for 1920 on taxable Liberty bonds.

EXPLANATIONS.

* Interest upon bonds issued by the War Finance Corporation, principal of which does not exceed \$5,000 in aggregate, is exempt from taxation under section 16, Act approved April 5, 1918, and is in addition to this exemption.

If books are kept on accrual basis, report amount of interest actually accrued whether received or not.

If books are kept on the basis of receipts and disbursements, report amount of interest actually received within the year, which will include amount of coupons falling due within the year (whether cashed or not) plus the amount of interest accrued upon bonds which are sold or otherwise disposed of during the year.

All interest on indebtedness incurred to purchase or carry obligations of the United States issued after September 1, 1917, may be claimed as a deduction under sections 214(a) (2) and 234(a) (2) of the Revenue Act of 1918 by a taxpayer rendering a return of income.

** The partners of a partnership and the stockholders of a personal service corporation are considered the original subscribers to any obligations of the United States subscribed for by the partnership or the personal service corporation.

*** "The date of filing the return" is held to be the actual date upon which the return is filed with the collector of internal revenue.

In the case of a trust, the income from which is taxable to the beneficiaries, each beneficiary is regarded as the owner of his proportionate part of the bonds, notes, and certificates held in trust and as the original subscriber of his proportionate part of fourth Liberty bonds and Victory notes subscribed for by such trust, and is entitled to the exemptions allowed on account of such ownership and subscription. If, on the other hand, the income from the trust is taxable to the trustee, the trustee should claim the allowable exemptions as owner of the bonds, notes, and certificates, or subscriber to the fourth Liberty bonds and Victory notes.

Interest received on and after March 3, 1919, on bonds, notes, certificates of indebtedness of the United States, and bonds of the War Finance Corporation, while beneficially owned by a nonresident alien individual or a foreign corporation, partnership, or association, not engaged in business in the United States, is exempt from income, excess profits, and war profits taxes.

Attention is invited to the use of Form 1125 for 1919 and subsequent years. Copies of this form may be secured from the collector.

INCOME, NET AND GROSS.

20. What is meant by the term "Net income"?

Net income means your total gross income, not including income wholly exempt by law from the tax, less the general deductions allowed by law.

21. In rendering a return, what items of income must I report as gross income?

Under gross income should be reported every item of income derived from any source whatever (except those specified in the answers to questions 18 and 19 as wholly exempt) received during the taxable year for which the return is rendered, whether received in cash or the equivalent of cash, including:

(a) All amounts of salary, wages, commissions, or compensation of whatever kind received for personal service (however, the salary of the President of the United States and the salaries of Federal judges elected or appointed prior to the enactment of the Revenue Act of 1918 are not subject to tax).

(b) All amounts of gain, profit, or income derived from any business or trade in which you are engaged or in which you have an interest and from any sale of property—real, personal, or mixed.

(c) Rents, interest on notes, mortgages, deeds of trust, or other securities issued by individuals, partnerships, etc., interest on bonds, mortgages, deeds of trust, or other similar obligations of corporations,

joint-stock companies, associations, or insurance companies, and interest on bank deposits.

(d) All income received from fiduciaries, that is, all amounts received from incomes of estates, trusts, etc., through trustees, administrators, or executors, unless the tax on such income was paid by the fiduciary prior to distribution. (It is to be understood that in cases where under the terms of the will or trust income of the estate is to be distributed regularly or annually the beneficiaries are required to return their distributive interests in such income whether actually distributed to them or not.)

(e) If you have an interest in a partnership you should report your distributive share of the earnings or profits of the partnership ascertained during the taxable year for which the return is rendered, whether distributed or not. If your net income for such taxable year is computed upon the basis of a period different from that upon the basis for which the net income of the partnership is computed, then your share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which your net income is computed is to be reported in your income tax return.

(f) All items of foreign income, including interest upon bonds and mortgages or deeds of trust or other similar obligations issued by individuals who are citizens or residents of foreign countries, foreign corporations, joint-stock companies, etc., and dividends from foreign corporations.

(g) Cash dividends on stock or from the net earnings of domestic corporations, joint-stock companies, associations, or insurance companies, whether paid in cash, property, or scrip. As the net earnings of corporations, joint-stock companies, etc., are subject to the tax imposed upon the net income of corporations, dividends from such net earnings are not subject to the normal income tax in the hands of the shareholders receiving them, but they are to be returned for surtax purposes, since they are subject to that tax.

(h) If you own stock in a personal service corporation (see art. 328, Regulations 45), you should report your distributive share of the net income of such corporation for 1920 in the same manner as outlined in paragraph (e) above.

22. If my salary for December, 1920, is not paid to me until some day in January, 1921, or later, is the amount to be reported in my 1920 return?

No; unless as a matter of settled practice your books were kept on an accrual basis, in which event it should be returned by you for the year 1920. If credited and made available to you on December 31, 1920, without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, although not actually drawn until later, it should also be reported as 1920 income. Otherwise it should be reported in your return for 1921.

23. If an employer agrees to pay an employee a certain stipulated salary and furnish him with room and board, are the latter items to be considered in computing income tax liability?

Yes; a fair rental value is to be placed upon the room and a fair value upon the meals furnished, and these amounts reported as income by the employee; however, if the room and board are fur-

nished purely for the convenience of the employer, the fair value thereof need not be included in the income of the employee.

24. An employee receives a per diem allowance for expenses in addition to his regular salary. Is this amount to be included as income in his return?

If an individual receives a salary and also an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, any excess of the cost of such meals and lodging over the allowance, plus the ordinary expenditures required for such purposes when at home, is deductible, but any excess of the allowance over such expenses minus such ordinary expenditures is taxable income.

25. If a person entered into a contract in 1920 which will not be completed until a later year, and which requires him to make expenditures for material and labor, provide for possible losses, etc., must he include the advance payments he received in 1920 in his return for that year?

Persons engaged in contracting operations who have uncompleted contracts, in some cases, perhaps, running for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work; that is, on jobs which have been finally completed any and all moneys received in payment will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from gross income should be limited to the expenditures made on account of such completed contracts. Or the percentage of profit from the contract may be estimated on the basis of percentage of completion, in which case the income to be returned each year during the performance of the contract will be computed upon the basis of the expenses incurred on such contract during the year; that is to say, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year. Upon the completion of a contract if it is found that, as a result of such estimate or apportionment, the income of any year or years has been overstated or understated, the taxpayer should file amended returns for such year or years.

26. A tenant, under the terms of a lease, is required to pay a certain cash rental and in addition make certain improvements. Is the cost of these improvements held to be taxable income to the property owner?

When buildings are erected or improvements are made by a lessee in pursuance of an agreement with the lessor, and such buildings or improvements are not subject to removal by the lessee, the lessor receives income at the time when such buildings or improvements are completed to the extent of the fair market price or value of such buildings or improvements subject to the lease. This amount would ordinarily be the difference between the value of the land free from the lease without such improvements and the value of the land subject to the lease with such improvements. If, for any other reason than a bona fide purchase from the lessee by the lessor, the lease is terminated, so that the lessor comes into possession and control of the property prior to the time originally fixed for the termination of the lease, the lessor receives additional income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he became entitled to such possession exceeds the fair market price or value thereof to him as deter-

mined when the same completed became part of the realty. No appreciation in value due to causes other than the premature termination of the lease shall be included. Conversely, if the buildings or improvements are destroyed prior to the termination of the lease the lessor is entitled to deduct as a loss of the year when such destruction takes place the fair market price or value of such buildings or improvements subject to the lease as determined when the same completed became a part of the realty, or the value thereof subject to the lease on March 1, 1913, less any salvage value subject to the lease, to the extent that such loss was not compensated by insurance.

27. Special payments, designated as "Bonuses," are often made to officers and employees of corporations, firms, and individuals. Are such items of income subject to tax in the hands of recipients?

Any bonus or other item of compensation paid to an employee in addition to his regular salary or wage under a contract, express or implied, as additional compensation for services rendered, as a reward for past endeavors, or as a stimulus to further zeal and enthusiasm in the discharge of his duties, is held to constitute taxable income, which should be reported as such in the employee's return rendered for the year during which received.

28. Should an individual who conducts a grocery, dry-goods, clothing, or farm implement business, or any other business which requires that a stock be carried, take an inventory at the close of each taxable year and take such inventories into consideration in arriving at his net income from business?

Yes; section 203 of the Revenue Act of 1918 provides that whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by the taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may approve or prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income of the taxpayer.

29. How am I to determine the amount of gain or profit derived from a sale of property which is returnable for income tax purposes?

If you acquired the property prior to March 1, 1913, you should take its fair market price or value as of that date, add thereto all amounts subsequently expended and not deducted as business expenses in making permanent improvements, then deduct the depreciation sustained, and the difference between the result thus obtained and the selling price is the amount to be reported.

If you purchased the property on or after March 1, 1913, the difference between its cost, plus all amounts subsequently expended for permanent improvements and not deducted as business expenses, less depreciation sustained, and its selling price is to be returned.

In computing the gain from the sale of a taxpayer's dwelling, with respect to which no depreciation deduction has been allowed, no adjustment need be made for depreciation sustained.

In the case of property acquired by gift, bequest, devise, or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition or as of March 1, 1913, if acquired prior thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise, or descent since February 28, 1913, its value as

appraised for the purpose of the Federal estate tax, or in the case of estates not subject to that tax its value as appraised in the State court for the purpose of State inheritance taxes, should be deemed to be its fair market value when acquired.

30. How is the value as of March 1, 1913, of property sold determined?

No method of determining such value can be stated which will adequately meet all circumstances. What that value was is a question of fact to be established by any appropriate evidence which is available in the particular case.

31. I owned property which I traded for other property during 1920. How am I to determine what amount of gain or profit derived from the transaction is to be reported for income tax purposes?

The profit is to be determined in the same manner as if the property was sold for cash. The property received in exchange should be treated as the equivalent of cash to the amount of its fair market value at the time of the exchange.

32. Are commissions on renewal premiums on insurance policies subject to income tax?

Yes; such commissions received by insurance agents on account of business written are taxable income for the year in which received.

33. I purchased a 6 per cent \$100 coupon bond at its face value, plus \$1.50; that is, three months' accrued interest. Three months later I detached a coupon therefrom and collected \$3 interest. Must the entire amount of interest received be returned as income?

No; report only so much interest as accrued after the date of your purchase. It is the seller's duty to report the balance.

34. Do the pensions and retired pay of ex-officers and men of the United States military and naval forces not on active duty constitute items of taxable income?

Pensions and retired pay of ex-officers and men of the United States Army, Navy, or Marine Corps, not on active duty, constitute items of taxable income; however, allotments, family allowances, compensation, insurance, etc., paid under the provisions of the War Risk Insurance Act of September 2, 1917, as amended, are exempt from taxation.

35. I own stock in a bank which, under a State law, is required to pay the taxes assessed against such stock. How is this matter to be handled for income tax purposes?

The proportionate part of the entire amount of taxes so paid by the bank, which is properly chargeable against the number of shares held by you, should be reported, for surtax purposes, in your personal return, as a dividend, and may then be deducted from gross income as a tax.

36. I purchased 10 shares of the preferred stock of a corporation and received 10 shares of common stock as a bonus. Has the value of this bonus a taxable status?

No; but the total purchase price is to be fairly apportioned between the preferred stock and the common stock received as a bonus, for the purpose of determining the proportion of the consideration attributable to each class of stock. The cost of each class so determined will be the basis for determining profit or loss upon the subsequent sale of such stock.

37. Are amounts placed to the credit of a shareholder in a building and loan association subject to income tax?

Any amount credited to a shareholder subsequent to March 1, 1913, when such credit passes to him without restriction, has a taxable status to him and should be included in his return rendered for the year during which the credit is made.

Where the amount of accumulations credited does not become available to the shareholder until the maturity of a share, it need not be reported as income until maturity of the share, at which time the amount received in excess of the total amount actually paid in by the shareholder is to be returned.

38. I hold stock in a corporation which in 1920 increased its capital stock and gave me the right to subscribe for additional stock at par. If I sell this "right," are the proceeds to be returned for tax purposes?

Yes; the entire proceeds from the sale of a "right" to purchase additional stock should be included in the return as income.

39. Are payments of alimony to be returned for tax purposes by the recipient?

Sums representing alimony are not taxable income to the recipient, nor allowable deductions to the person paying them.

40. Where services are rendered and paid for with something other than money, shall consideration be given the transaction for income tax purposes?

Yes; where services are paid for with something other than money the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary, such price will be presumed to be the fair value of the compensation received.

DIVIDENDS.

41. In 1920 I received a dividend of \$10,000 from company "A," which was paid in stock of company "B." Is this \$10,000 to be considered a stock dividend within the meaning of the income tax law?

No; a stock dividend is a distribution by a corporation to its stockholders of capital stock of the distributing corporation. A distribution of stock other than that of the distributing corporation is not a stock dividend but is to be regarded as a dividend paid in property. The fair market value of the stock at the time of receipt should be reported as income.

42. In 1920 I owned stock in a corporation which declared and paid a stock dividend. Is this stock dividend taxable?

No; in the case of *Eisner v. Macomber* (T. D. 3010) the Supreme Court of the United States decided that stock dividends do not constitute taxable income.

43. I own 10 shares of common stock of a corporation on which I received a stock dividend of 5 shares of common stock which I intend to sell. How will my profit or loss on the sale of the 5 shares be determined?

For the purpose of ascertaining the gain or loss derived from the sale of such stock the "cost" of each share is the quotient of the cost of the old stock (or its fair market value as of March 1, 1913, if acquired prior to that date) divided by the number of the old and new shares added together. The difference between the selling price and the cost of the stock so determined is the amount of the gain or loss, as the case may be.

44. Are dividends on paid-up life insurance policies subject to income tax? Dividends on paid-up life insurance policies are not subject to normal tax but are subject to surtax for the year in which received.

DEDUCTIONS.

45. What items may a taxpayer deduct in ascertaining his net income from all sources?

In arriving at his net income from all sources he is entitled to deduct from gross income the following items:

(a) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including reasonable allowance for salaries or other compensation for personal services actually rendered, and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after Sept. 24, 1917), the interest upon which is wholly exempt from income tax.

(c) Taxes paid or accrued within the taxable year imposed by the authority of the United States, except income, war profits, and excess profits taxes; or by the authority of any of its possessions, except the amount of income, war profits, and excess profits taxes allowed as a credit under section 222 of the Act; or by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; and by the authority of any foreign country, except the amount of income, war profits, and excess profits taxes allowed as a credit under section 222 of the Act.

(d) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business.

(e) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with one's trade or business.

(f) Losses sustained during the taxable year of property not connected with the trade or business, if arising from fires, storms, shipwreck, or other casualty or from theft, and if not compensated for by insurance or otherwise.

(g) Debts ascertained to be worthless and charged off during the taxable year.

(h) A reasonable allowance for the exhaustion, wear, and tear of property used in trade or business, including a reasonable allowance for obsolescence.

(i) A reasonable allowance for depletion in the case of mines, oil and gas wells, other natural deposits, and timber.

(j) Contributions or gifts made within the taxable year to corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of

cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act, to an amount not in excess of 15 per cent of the taxpayer's net income from all sources as computed without the benefit of this paragraph.

46. What constitutes an item allowable as a deduction as a business expense?

All amounts of ordinary and necessary expenses paid or incurred during the taxable year in the conduct of a business, trade, or profession.

This includes all amounts paid by a farmer for labor in preparing his land for a crop and the cultivation, harvesting, and marketing of the crops, the cost of the seed and fertilizer used; the amounts expended for labor used in caring for live stock and the cost of the feed. The amounts actually paid in making repairs to farm buildings, but not the dwelling house; repairs to fences, farm machinery, etc.; the cost of materials for immediate use and farm tools which are used up in the course of a year or two, such as binding twine, stock powders, pitchforks, spades, etc.; and the amount of rent paid for a farm may also be claimed.

A merchant may claim as deductions the amounts paid for advertising, hire of clerks and other employees; the cost of the light, fuel, water, telephones, etc., used in or at his place of business; drayage and freight bills; the cost of operating delivery wagons, trucks, and the repairs to same.

A physician may claim as deductions the cost of medicines and medical supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to medical societies and subscriptions to medical journals, the expenses of attending medical conventions, the rent paid for office rooms and the hire of office assistants, the cost of the fuel, light, water, telephone, etc., used in such office rooms. Amounts expended for books, medical supplies, and surgical instruments of a permanent character are not allowable as deductions.

This in a general way outlines the ordinary and usual expenses incurred by a farmer, a merchant, or a professional man, which may be claimed as deductions, and the principles underlying these allowances are equally applicable in the case of anyone engaged in a business, trade, or profession. In short, all expenses connected directly and solely with the conduct of an income-producing business, trade, profession, or vocation are allowable.

Items of personal expense or items connected in any way with the support, maintenance, and well-being of a family are not allowed; neither are the amounts paid for tools, implements, vehicles, machinery, or surgical instruments which are more or less permanent in character, nor the cost of medical, law, or other professional books, nor amounts expended in making permanent improvements or betterments of any kind whatsoever, allowable as deductions. These latter items are held to be investments of capital upon which depreciation may be claimed.

No expenses or depreciation in connection with a taxpayer's personal residence, or automobiles or other property used exclusively for

pleasure can be properly deducted under the provisions of the income tax law, as such expenses and depreciation represent "personal living or family expenses."

47. If I employ a minor son or daughter to assist me in my business or trade and I pay a reasonable salary or wage for such assistance, may I claim the amount as a deduction?

No; if, however, the son or daughter has attained his or her majority, or has been emancipated, the amount of compensation paid for his or her services may be so claimed.

48. May a taxpayer claim a deduction for his own remuneration?

Wages or salary drawn by a taxpayer from his own business are more in the nature of a charge out of profits than a charge against profits. If such could be deducted they would merely be added to his income, the effect of which would be to take money out of one pocket and put it in another. Therefore no deduction may be claimed for income tax purposes.

49. May the amounts expended by a business man in entertaining out-of-town customers, or prospective customers, be claimed as deductions?

Yes; if the sole purpose of the business man in making such expenditures is to cultivate the good will of his customers and secure an increase in trade they may be so claimed.

50. A who is employed in a city, has his home in a suburb. He pays car fare between his home and place of employment and takes his noon lunch in the city. May the amounts expended for car fare and lunch be claimed as a business expense?

No; such amounts are held to be items of personal expense.

51. I am a traveling salesman and desire to know how my income and traveling expenses should be handled in my personal return.

Traveling expenses, as ordinarily understood, include railroad fares and meals and lodging. If the trip is undertaken for other than business purposes, such railroad fares are personal expenses and such meals and lodging are living expenses. If the trip is on business, the reasonable and necessary traveling expenses, including railroad fares, and meals and lodging in an amount in excess of any expenditures ordinarily required for such purposes when at home, become business instead of personal expenses. (a) If, then, an individual whose business requires him to travel receives a salary as full compensation for his service, without reimbursement for traveling expenses, or is employed on a commission basis with no expense allowance, his expenses for railroad fares, and expenses for meals and lodging in an amount in excess of any expenditures ordinarily required for such purposes when at home, are deductible from gross income. (b) If an individual receives a salary and is also repaid his actual traveling expenses, he shall include in gross income an amount thereof equal to the ordinary expenditures required for meals and lodging when at home, as such amount is held to be additional compensation to the taxpayer. (c) If an individual receives a salary and also an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, any excess of the cost of such meals and lodging over the allowance plus the ordinary expenditures required for such purposes when at home, is

deductible, but any excess of the allowance over such expenses minus such ordinary expenditures is taxable income. Congressmen and others who receive a mileage allowance for railroad fares should return as income any excess of such allowance over their actual expenses for such fares. A payment for the use of a sample room at a hotel for the display of goods is a business expense. This contemplates that only such expenses as are reasonable and necessary in the conduct of the business and directly attributable to it may be deducted. A taxpayer claiming the benefit of the deductions referred to herein must attach to his return a statement showing (1) the nature of the business in which engaged; (2) number of days away from home during the calendar year on account of business; (3) number of members in taxpayer's family dependent upon him for support; (4) average monthly expense incident to meals and lodging for entire family, including taxpayer himself when at home; (5) average monthly expense incident to meals and lodging when at home if taxpayer has no family; (6) total amount of expenses incident to meals and lodging while absent from home on business during taxable year; (7) total amount of excess expenditures incident to meals and lodging while traveling on business and claimed as a deduction; (8) total amount of other expenses incident to travel and claimed as a deduction.

Claim for the deductions referred to herein must be substantiated, when required by the Commissioner, by records showing in detail the amount and nature of the expenses incurred.

52. Are the items of expense incurred and paid by me during the taxable year in connection with a farm which I lease to another on a cash or crop-share rental basis, such as repairs to fences, farm buildings, etc., allowable as deductions?

Yes.

53. May the amount of life insurance premiums and premiums paid for insurance on my residence be claimed as deductions?

No; these are held to be items of personal expense. If, however, a farmer pays premiums on insurance policies covering farm buildings, other than his dwelling house, or on any property used for business purposes, these premiums are allowable as deductions.

54. An individual or a partnership insures the life of one or more employees or members. May the premiums paid for such insurance be considered a business expense and claimed as a deduction?

Section 215 of the Revenue Act of 1918 specifically provides that no deduction shall be allowed for premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

55. A tenant, under the terms of a lease, is obligated to pay a certain cash rental on property used for business purposes and all taxes assessed against the property and to keep it insured. May he claim as a business expense the aggregate amount of rental, taxes, and insurance premiums paid?

Yes: if the property is used by the tenant for business or trade purposes and not as a home.

56. I own stock in a corporation which, in 1920, assessed each of its stockholders \$50 on each share held. May the amount paid by me be claimed as a deduction?

No; assessments made by a corporation on its capital stock are regarded as further investments of capital and do not constitute an allowable deduction. The amount so paid should be added to the original cost of the shares of stock in computing gain or loss from the subsequent sale thereof.

57. In California and other States fruit growers, ranchers, and farmers are shareholders in irrigation companies which are mutual in character, and they are often assessed in proportion to their holdings of stock, for sufficient amounts to make repairs to the irrigation system, cleaning out of pipes, laterals, etc. May such assessments be claimed as deductions under the head of business expenses?

Yes; where the purpose of the assessment is merely to raise funds to keep the irrigation system in usable condition and not to make extensions or betterments, the amount assessed against each shareholder may be so claimed if the payment of such amount is necessary to the conduct of his business.

58. If a physician or other professional or business man rents a home and uses a portion of it for professional or business purposes, may any portion of the rent paid for that home be claimed as a business expense?

Yes; the proportion of the rent paid which is properly chargeable to the number of rooms used for professional or business purposes may be claimed as a deduction.

59. In 1920 I purchased a property, the title to which proved defective, and in order to straighten the matter out I employed an attorney and resorted to court proceedings. May I claim a deduction to cover the fee paid the attorney and the court costs?

No; such items are held to be a part of the cost of the property and therefore not allowable as deductions.

60. If I employ an architect to prepare plans for a building to be used for business purposes, may the fee paid to the architect be claimed as a business expense?

No; amounts expended for an architect's services are held to be a part of the cost of the building and not such items as may be claimed as deductions.

61. May a business or professional man who keeps a set of books and enters thereon as income sales of goods on credit, or fees earned but not paid, and charges to expense account items which have been incurred but have not been paid by him, report his net income for the year as shown by his books when they are balanced at the end of the taxable year?

Yes; section 212 of the Revenue Act of 1918 provides that net income shall be computed in accordance with the method of accounting regularly employed in keeping the taxpayer's books. The method employed must, of course, clearly reflect the taxpayer's net income.

62. If I have a certain sum of money invested in a farm or business, may I claim as a deduction, under the head of interest, an estimated amount of interest which might have accrued to me had that money been deposited in a bank or invested in interest-paying securities?

No.

63. What forms of taxes are not deductible on account of being taxes assessed against local benefits?

Taxes assessed against an individual on property owned by him to pay for the paving of a street contiguous to his property, the con-

struction of a sewer, sidewalk, etc., or the construction of ditches to drain property owned by him, can not be claimed as deductions. In short, taxes that are not general in nature and are levied on account of some work or privilege the benefit of which accrues to a limited number of property owners, of which the taxpayer is one, are not allowable deductions.

64. If I pay any amount of Federal personal income tax for the year 1919, may I claim that amount as a deduction for the year 1920?

No; the income tax law states that income taxes are not allowable as deductions. Under this provision income tax paid in 1920 on income received in 1919 or any previous year can not be deducted. State income taxes are deductible.

65. In 1917 I bought certain stocks and bonds for \$5,000, and in 1920 the value of these securities dropped to \$4,000. May I claim the difference of \$1,000 as a loss in computing my income tax liability?

No; under the provisions of section 214(a) 4, 5, 6 of the Revenue Act of 1918 only such losses as have been sustained during the taxable year can be claimed; that is, the loss must have resulted from a completed and closed transaction. In your case you still own the securities. They may go up in value during 1921, and until they are sold or otherwise disposed of you are unable to determine whether you will suffer a loss or derive a gain from the investment. In other words, no account is to be taken for income tax purposes, of fluctuations in the market value, or arbitrary changes in the book value of securities or other property. (See art. 1585 of Regulations 45 as to "dealers in securities.")

66. John Doe, while driving an automobile for pleasure, ran down and injured another person. He either paid over a certain sum or paid a judgment rendered against him in settlement of the injury done. May he claim the amount so paid as a loss?

No; it was not a loss which was incurred in the conduct of his business or trade, or which resulted from a transaction entered into for profit.

67. How am I to determine what amount of loss, resulting from a sale of property, is allowable as a deduction?

The same method of computation should be followed as is outlined in the answer to the twenty-ninth question. A loss sustained by an individual from the sale of residential property is deductible in determining net income for purposes of the Revenue Act of 1918 only when the property was purchased or constructed by him with a view to its subsequent sale for pecuniary profit. The intent in purchasing or constructing the property is a question of fact determinable in each case by evidence which should be submitted with the return.

68. A professional man or a merchant owns and operates a fancy stock farm for recreation or pleasure. The expenses of operation exceed the gross receipts. May the difference be claimed as a deduction under the head of losses?

No; it is held that where a farm is operated for purposes of recreation or pleasure and not for gain or profit and the expenses of operation exceed the gross receipts, that farm is not to be classed as a commercial enterprise, and it does not form a part of its owner's

business or trade. The gross receipts are not to be reported under gross income and the expenses are not to be claimed as a deduction. This ruling, of course, precludes the claiming of the difference between the two amounts as a loss.

69. Supposing I buy a farm which is much run down with the intention of making it a profit-paying property; that is, I intend to operate it for profit and not for recreation or pleasure. To do this I am obliged to expend large amounts for labor in plowing and cultivating the land, for fertilizer, lime, etc., and for several years the expenses will greatly exceed the gross receipts. May the excess of expenses over receipts for each year be claimed as a loss?

It is held that all the ordinary and necessary expenses of cultivating, operating, or managing a farm on a basis embodying the recognized principles of commercial farming, for the purpose of gain or profit and not for recreation or pleasure, except amounts which are regarded under article 110 of Regulations 45 as investments of capital, may be claimed as deductions in returns of income, even though these expenses exceed the income from the farm and the result is a continual loss, provided the farm is continued to be operated on a strictly commercial basis.

70. I own a tract of timber which was partially destroyed by fire during 1920. Is this loss allowable as a deduction?

The actual amount of capital invested in standing timber, if acquired on or after March 1, 1913, and later destroyed by fire, may be claimed as a deduction if not reimbursed by insurance or otherwise. If the timber was acquired prior to March 1, 1913, its fair market price or value as of that date may be claimed. To illustrate the method to be employed in computing the amount of loss allowable as a deduction, the following is submitted: A tract of land was acquired prior to March 1, 1913, and the estimated amount of timber standing on that tract on that date was 1,000,000 feet, board measure, the fair market price or value per 1,000 feet established by the current prices prevailing in the locality of the tract in question as of March 1, 1913, being \$4. During the year 1920, 400,000 feet of this timber was destroyed by fire. In this case \$1,600 is the amount which may be claimed as a deduction.

71. If a crop which is ready to be harvested, but has not been gathered, or a crop which has been harvested, but has not been sold, is destroyed by storm, flood, or fire, may the value of that crop be claimed as a deduction?

No; unless the crop has been taken into the taxpayer's inventory and used in computing his taxable net income for a specific year. It is understood, of course, that the actual cost of producing or harvesting a crop which has been so destroyed may be deducted as a business expense.

72. What conditions are necessary in order that a debt may be claimed as a deduction?

(a) It must be a bona fide debt; (b) surrounding and attendant circumstances must indicate that the debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment; and (c) if books are kept it must be charged off within the year for which the deduction is claimed and no longer considered an asset or carried as such on the books.

73. In 1920 a corporation or a firm to which I had loaned money since March 1, 1913, became bankrupt. May this debt be considered absolutely worthless and claimed as a deduction for 1920?

Yes; if it is definitely known that nothing can be collected from the debtor itself or any person connected with it.

74. Is it absolutely necessary that the debtor corporation or firm mentioned in the preceding inquiry be declared a bankrupt and its receiver discharged before I may claim a deduction on account of the debt in question?

No; if the debtor corporation has no assets whatsoever available for application to the debt in question, and it is definitely known that nothing whatsoever can be collected from the debtor itself or any person connected with it, a creditor need not go to the expense of instituting bankruptcy proceedings in order to establish his right to claim the worthless debt as a deduction.

75. A indorses a note for B. The latter has since departed for parts unknown. The note became due in 1920, and A was required to make good his indorsement. May he now claim as a deduction the amount paid by him to the creditor?

Yes.

76. If, on account of friendship or relationship, I advanced a certain sum to assist a needy friend or relative, and at the time such advance was made I had little or no reason to expect that the amount so advanced would ever be returned, may I now claim a deduction to cover such advance?

No; such an advance is regarded as a gift and is not held to constitute a bona fide debt.

77. In rendering my 1915 return I claimed a deduction to cover a debt I then believed to be absolutely worthless. In 1920 the debtor has discharged a part of his obligations. How should I treat this payment for income tax purposes?

Consider it as an item of income and include the amount in your return.

78. A professional man earned a fee in 1917. As he keeps no books, he reports his income for tax purposes on a cash-receipts basis. As this fee has never been reported as income, may it be claimed as a deduction if collection can not be made?

No; since it has not been returned as income, it can not be claimed as a deduction.

DEPRECIATION.

79. At what rates may depreciation be claimed and under what conditions?

The deduction for depreciation in income tax returns is a means whereby exemption from the tax may be secured upon the amount of capital invested in physical property (or in case of property acquired by gift or bequest the value of such property) which is subject to exhaustion through wear and tear arising out of its use or employment in business or trade, or on account of obsolescence. Therefore, the annual allowance for depreciation should be based upon the life of the property; that is, the cost of the property or the value of the same where acquired by gift or bequest, or its fair market price or value as of March 1, 1913, if acquired prior thereto, should be ratably spread over its life. For instance, the rate of depreciation to be deducted on buildings used for business purposes,

the probable life of which is 50 years, would be 2 per cent. The probable life means, of course, the number of years the property would be usable in business from the date of acquisition or in case of property acquired prior to March 1, 1913, the number of years the property would be usable from March 1, 1913. In the case of property acquired by gift or bequest, the "cost" of such property for depreciation purposes is the appraised value at the time the property was acquired. If property in respect of which depreciation is claimed was acquired prior to March 1, 1913, the fair market value as of that date will be assumed in the absence of proof to the contrary to be the cost of the property less depreciation up to that date.

In claiming depreciation the following fundamental principles must be taken into consideration:

(a) Only such depreciation as results from exhaustion, wear and tear of property, arising out of its use or employment in business or trade, or on account of obsolescence, may be claimed. Depreciation in the value of a home or any article of property, such as automobiles used exclusively for personal pleasure or convenience, may not be claimed; the property must be used for the purpose of producing income.

Depreciation in the value of land, whether improved or unimproved, due to ordinary erosion, exhaustion, or any other cause, may not be claimed.

Where, in the course of years, the owner of property has claimed its full cost or its fair market value as of March 1, 1913, as depreciation in his income tax returns no further claim will be allowed.

(NOTE.—For information relative to deduction for obsolescence see Regulations 45 and Bulletin F.)

80. Am I entitled to a deduction for depreciation of my personal residence, furniture and fixtures therein, and an automobile which I use only for pleasure and recreation?

No; depreciation sustained on such property is considered a personal expense and not deductible for income tax purposes.

81. In 1920 I bought a patent for \$5,000 which, under the patent laws of the United States, has five years yet to run. As the value of this patent depreciates each year on account of the exhaustion of the patent period, may a deduction be claimed?

Yes; the cost of the patent divided by the number of years it yet has to run is the amount which may be claimed each year as depreciation. In your case this amount is \$1,000.

82. Members of the theatrical profession are frequently required to furnish their own costumes. Are they entitled to a deduction for depreciation of such property?

If costumes purchased by members of the theatrical profession are used exclusively for the production of a play and are not adapted for occasional personal use, and are not so used, a deduction may be claimed on account of such depreciation in their value as occurs during the year on account of wear and tear arising from their use in the production of the play or from their becoming obsolete at the close of the production. In such case the cost of the costumes in the first instance must not have been claimed as an expense.

DEPLETION.

83. Under what conditions and at what rates may depletion due to the removal of a natural product from oil or gas wells, mines, quarries, etc., be claimed?

Section 214, paragraph 10, of the Revenue Act of 1918, states how the amount of depletion allowable as a deduction is to be ascertained, but as so many factors are to be considered in computing depletion, an answer which will be applicable in all cases where depletion occurs can not here be given. Such factors are covered in considerable detail by Regulations 45, copies of which may be obtained from the collector of internal revenue for your district, and where these regulations do not afford all the information necessary in your particular case a detailed statement covering all the facts and figures in your case should be forwarded to the collector with a request for a ruling.

CONTRIBUTIONS AND GIFTS TO RELIGIOUS, CHARITABLE, AND SCIENTIFIC ORGANIZATIONS, ETC.

84. With reference to the eleventh paragraph of section 214 of the Act, how am I to determine to what extent contributions or gifts made to corporations, organized and operated exclusively for religious, charitable, scientific, or educational purposes or for the prevention of cruelty to children or animals or to the special fund for vocational rehabilitation, may be claimed as a deduction?

You should first ascertain what your taxable net income would be were you not entitled to a deduction on account of such contributions or gifts, and then if the aggregate of your contributions and gifts made during the year to such organizations does not exceed 15 per cent of your taxable net income so computed, their aggregate amount may be entered in the place provided therefor under "Contributions" on a personal return form. If such aggregate amount exceeds 15 per cent of your taxable net income so computed, the excess can not be claimed.

For example: Your total taxable net income amounts to \$20,000. During the year you have contributed to the American Red Cross \$1,000, to the Young Men's Christian Association \$1,000, toward the construction of a new church \$1,000, and to the Associated Charities of your home city \$500, a total of \$3,500. Fifteen per cent of your total net income amounts to \$3,000. Therefore this latter amount may be claimed as a deduction and the balance of your contributions and gifts may not be claimed.

In claiming a deduction on account of such contributions or gifts there should be shown on the return of income (a) the name and address of each organization to which a contribution or gift was made and (b) the date and amount of each such contribution or gift.

Where a gift is other than money the basis for calculation of the amount of the gift shall be the cost of the property, if acquired after February 28, 1913, or its fair market value as of March 1, 1913, if acquired prior thereto, after deducting from such cost or value the amount, if any, which has been or which should have been set aside and deducted in the current year and previous years from gross income on account of depreciation, and which has not been paid out in making good the depreciation sustained.

85. During 1920 I contributed \$100 toward the support of a needy family. May this contribution be claimed as a deduction?

Contributions or gifts made to individuals do not constitute allowable deductions.

86. Am I entitled to any deduction by reason of contributions or gifts made in 1920 by a partnership of which I am a member to the organizations mentioned in question 84?

Yes; since the partnership may not deduct the amount of such contributions or gifts in computing its net income, you may deduct your proportionate share of the contributions or gifts, but your total deduction for contributions or gifts may not exceed 15 per cent of your net income.

RATE OF TAX.

87. Upon what is the surtax based?

The surtax imposed by section 211 of the Act is based upon the total amount of net income from all sources in excess of \$5,000.

88. A prospector discovers a mine, which he sells at a large profit. Is the entire profit derived from the sale of the mine subject to the surtax imposed by section 211?

Section 211 of the Act provides that in the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the surtax attributable to such sale shall not exceed 20 per cent of the selling price of such property.

89. In computing my income subject to normal tax, to what credits against my net income from all sources am I entitled?

For the purpose of the normal tax only you are entitled to the following credits:

(a) The amount received as dividends from corporations which are taxable upon their net income and amounts received as dividends from personal service corporations out of earnings or profits upon which income tax has been imposed. (See secs. 200 and 201 of the Revenue Act of 1918.)

(b) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation which has been included in gross income.

(c) The amount of personal exemption specified in the answer to question 13.

90. Am I entitled to any credits against the total tax computed on my income from all sources?

If any income tax has been withheld from any of your income and paid at the source, you are required to include the amount of the tax withheld in your gross income and may then credit such tax against your total income tax liability.

Under certain conditions you may also be entitled to a credit for income and excess profits taxes paid to foreign countries upon income from sources therein. Where credit for income and profits taxes paid to foreign countries upon income from sources therein is claimed, Form 1116 must be properly filled out and executed. See section 222 of the statute and articles 381-385 of Regulations 45 for further information.

91. What is the rate of normal tax imposed for the taxable year 1920?

Section 210 of the Act provides that there shall be levied, collected, and paid upon the net income of each individual for each calendar year after 1918, a normal tax of 8 per cent of the amount of the net income in excess of the credits specified in the answer to question 89, except that in the case of a citizen or resident of the United States the rate upon the first \$4,000 of such excess amount is 4 per cent.

PARTNERSHIPS.

92. Are partnerships subject as such to the Federal income tax and required to render annual income tax returns?

Section 224 of the Act provides that every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

Section 218 of the Act provides that individuals carrying on business in partnership shall be liable for income tax only in their individual capacity; therefore no tax is assessed on the basis of the return filed by the partnership. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.

This section of the law also provides that a partner shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits specified in the answer to question 89, his proportionate share of such amounts specified in paragraphs (a) and (b) of that answer as are received by the partnership.

The net income of the partnership is to be computed in the same manner and upon the same basis as provided for individuals except the deduction referred to in paragraph (j) of the answer to question 45 is not allowable.

FIDUCIARIES.

93. Who are classed as fiduciaries?

The term "fiduciary" is one that applies to all persons or corporations that occupy positions of peculiar confidence toward others, such as trustees, executors, or administrators, and a fiduciary for income tax purposes is any person or corporation that holds in trust an estate of another person or persons or receives and controls income of another.

There may be a fiduciary relationship between an agent and the principal, but the word "agent" does not denote a "fiduciary" within the meaning of the income tax law.

A fiduciary relationship for the purposes of the income tax can not be created by a power of attorney. An agent having entire charge

of property, without authority to effect and execute leases with tenants entirely on his own responsibility, and without consulting his principal, paying taxes and expenses, and all other charges in connection with the property out of funds in his hands from collections of rents, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by power of attorney, is not a "fiduciary" within the meaning of the income tax law. In all cases where no legal trust has been created in the estate controlled by the agent and attorney the liability under the law rests with the principal.

94. Is the duly appointed guardian of a minor or the conservator of an estate of an incompetent person required to render personal returns for and in behalf of his ward?

Yes; under the same conditions as would the ward if competent to act for himself, and in so doing the personal exemption to which the ward is entitled may be claimed.

95. Is the duly appointed administrator of an estate of a deceased person who died during the tax year required to render a personal return for and in behalf of the deceased, and also his estate?

If the net income of the deceased from January 1 of the year during which he died to the date of his death equaled or exceeded \$1,000 in the case of an unmarried person or \$2,000 in the case of a married person, the administrator should file a personal return, executed on Form 1040, for and in behalf of the deceased, and a return executed on the same form will also be required of him for and in behalf of the estate, if it remains in process of administration and its net income from the date of the decedent's death to December 31, not properly paid or credited to any beneficiary, equals or exceeds \$1,000.

The administrator will be required to pay and will be held liable for any amount of tax which may be assessed on the basis of any such return rendered by him.

If the amount of net income properly paid or credited to any beneficiary equals or exceeds \$1,000, a separate return on Form 1041 should be made for the estate or trust.

96. What returns are required from a fiduciary in the United States where the beneficiaries of the trust are nonresident alien individuals?

Where a fiduciary in the United States is the recipient of trust income for which there is but one beneficiary, and that beneficiary a nonresident alien, the fiduciary will be required to make full and complete return on income tax Form 1040 or Form 1040-A for this trust income, on behalf of the nonresident alien, and pay any and all tax shown by such return to be due. The fiduciary should also make a return on Form 1041 for the estate or trust. Where there are two or more beneficiaries, one or all of whom are nonresident aliens, the fiduciary shall render a return on Form 1041 for and in behalf of the estate or trust and a personal return on Form 1040 or Form 1040-A for each nonresident alien beneficiary.

97. In what case is a fiduciary liable to render a return?

Every fiduciary, or at least one of joint fiduciaries, must make a return (a) for the individual whose income is in his charge, if the net income of such individual is \$2,000 or over, if married and living with husband or wife, or is \$1,000 or over in other cases, or (b) for the estate or trust for which he acts, if the net income of such estate

or trust is \$1,000 or over, or if any beneficiary of such estate or trust is a nonresident alien. The return in case (a) and also in case (b) if the tax is payable by the fiduciary shall be on Form 1040, revised, except that it may be on short Form 1040-A, revised, where the net income does not exceed \$5,000. The return shall be on Form 1041, revised, in case (b) if the tax is payable by the beneficiaries. If the net income of a decedent from the beginning of the taxable year to the date of his death was \$1,000, if unmarried, or \$2,000, if married, the executor or administrator shall make a return for such decedent.

98. For the purpose of the normal tax, what credits are allowed estates in the process of administration and estates held in trust for the accumulation of income?

In such cases the estate or trust is allowed the same credits as are allowed to single persons. (See answer to the 89th question.)

99. How is the net income of estates and trusts to be computed?

The net income of estates and trusts is to be computed in the same manner and on the same basis as provided for individuals, except that in lieu of the deduction for "contributions" specified in paragraph (j) of the answer to the 45th question, there is to be allowed as a deduction any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, or any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder, and in cases of income which is to be distributed to the beneficiaries periodically and in cases of income collected by a guardian of an infant to be held or distributed as the court may direct, the fiduciary should include in the return a statement of each beneficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

100. In a case where an estate is in process of administration and the fiduciary renders returns covering the income and deductions of the estate, and pays the amount of normal and additional tax assessed thereon, will the net income be subject to tax in the hands of the beneficiaries when received by them?

No; the taxes having once been paid, such income is exempt from tax in the hands of the beneficiaries who receive the same.

101. Is any other than a return of income required of a fiduciary?

Yes; fiduciaries come within the provisions of section 256 of the Revenue Act of 1918, and will be required to render to the Commissioner of Internal Revenue a return of information, if, during the taxable year, any income has been paid to an individual, partnership, personal service corporation, joint-stock company, etc., equal to, or in excess of \$1,000. A return of information is required showing the distributive share of each beneficiary, irrespective of amount.

102. Is a fiduciary required to deduct and withhold at the source any amount of normal income tax?

Yes; if any payment of fixed or determinable annual or periodical gains, profits, or income other than dividends or interest on tax-free bonds is made to nonresident alien individuals or nonresident foreign

corporations, 8 per cent and 10 per cent, respectively, is to be deducted and withheld and return thereof is to be made on Form 1042 accompanied by Form 1098.

103. Is an ancillary administrator required to render income tax returns covering income received by him?

An ancillary administrator is held to be merely the agent of the domiciliary administrator. The former should transmit to the latter all information as to income received by him in order that the domiciliary administrator may make a return covering the entire income of the estate. An ancillary administrator need make no separate return if the domiciliary administrator includes in his return the entire income of the estate.

104. Have the beneficiaries of an estate or trust a right to inspect income tax returns rendered by a fiduciary covering the income of the estate or trust in which they are interested?

Beneficiaries are not entitled, as such, to an inspection of returns of income filed by such a fiduciary.

105. Who is liable for payment of the tax assessed against the net income of an estate or trust?

Liability for payment of the income tax attaches to the person of the fiduciary up to and including the date of his discharge.

106. May an executor or administrator render his fiduciary returns prior to the close of the calendar year in a case where the estate is finally distributed and he is discharged from and relieved of his trust during that year?

An administrator or executor may, immediately after his discharge upon final accounting, file with the proper collector of internal revenue a return covering the income and deductions of the estate for the period January 1 to the date of his discharge. To such a return there should be attached a certificate, under seal, setting forth the fact of the final accounting and discharge of the administrator or executor, and the tax assessed against that return may be paid immediately after receipt from the collector of a notice of the amount assessed and a demand therefor.

107. Where, in the case of more than one trust, the creator in each instance is the same person, and the trustee in each instance is the same, how will the trustee account for the income of the several trusts?

The trustee should make a single return on Form 1041 for all the trusts in his hands, notwithstanding the fact that they arise from different instruments. When a trustee holds trusts created by different persons for the benefit of the same beneficiary he should make return for each trust separately on Form 1041. This ruling is based on the identity of the creator of the various trusts and not upon the identity of the beneficiary.

108. May the expenses of administration of an estate be claimed by the administrator as deductions in computing the estate's liability for income tax?

No; expenses of administration of an estate are not allowable as deductions.

WITHHOLDING OF TAX.

109. At what rates and from what income is the normal tax to be deducted and withheld at the source?

All individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal

property, fiduciaries, employers, and all officers and employees of the United States, making payment of fixed or determinable annual or periodical gains, profits, and income to any nonresident alien individual (other than dividends received from a corporation which is taxable on its net income and interest on bonds containing a tax-free covenant clause), are required to deduct and withhold normal tax at the rate of 8 per cent from such income. When such income is paid to foreign corporations not engaged in trade or business in the United States and not having an office or place of business therein, the rate of withholding is 10 per cent.

When interest upon bonds, mortgages, or deeds of trust or similar obligations of a domestic or resident corporation which contain a so-called tax-free covenant clause is paid to nonresident alien individuals, partnerships, or foreign corporations having no office or place of business in the United States, tax at the rate of 2 per cent should be withheld by the debtor corporation.

The tax is not to be withheld from income paid to a citizen or resident of the United States or to a partnership or personal service corporation, except when derived from interest on bonds or similar obligations of domestic or resident corporations containing a tax-free covenant clause. In such case the corporation issuing the bonds should withhold a tax of 2 per cent from interest payments thereon, unless the citizen or resident claims personal exemption by filing ownership certificate, Form 1001, revised, when collecting such interest. Where the owner of tax-free covenant bonds is unknown, withholding must also be made at the rate of 2 per cent. The income of domestic and resident foreign corporations is free from withholding.

110. What is the distinction between resident and nonresident aliens?

Any alien living in this country who is not a mere transient is a resident for the purposes of the income tax. A typical transient is one who in the course of a trip through the United States stops at various places, sometimes performing labor, sometimes not, or one who enters the United States intending only to stop long enough to carry out some purpose, object, or plan not involving an extended stay. If an alien lives in the United States and has no definite intention as to his stay, he is to be regarded as a resident. A nonresident foreign corporation is a foreign corporation which is not engaged in trade or business within the United States and does not have an office or place of business therein.

111. May a nonresident alien obtain the benefit of personal exemption and credit for dependents by filing a claim therefor with the withholding agent?

A nonresident alien may, if entitled under the provisions of section 216 of the Act, claim exemption from withholding by filing a claim with the withholding agent for the benefit of personal exemption or credit for dependents, or both, in two instances. First, a nonresident alien employee may file Form 1115, revised, with his employer, which will prevent the tax from being withheld from his salary or wages. Second, if any part of a nonresident alien's income from sources within the United States is from interest on bonds containing a tax-free covenant clause, and his gross income does not exceed his personal exemption, he may file a claim for personal exemption with the withholding agent at the end of the calendar year, or not later

than February 1 of the succeeding year, on Form 1001-B. In all other cases the tax must be withheld at the prescribed rates, and the taxpayer left to his remedy by filing a claim for credit or refund in event he is entitled to credits for personal exemption and dependents.

112. How may a nonresident alien obtain credit or refund of tax withheld at the source?

Credit or refund may be obtained only by filing a complete return of income from sources within the United States. Where upon filing a complete return it appears that a nonresident alien is entitled to personal exemption or credit for dependents, or both, as provided in section 216 of the Act, and tax in excess of the amount properly due has been withheld at the source, claim for credit for such excess should be made on Form 47-A or claim for refund on Form 46, revised. Nonresident foreign corporations obtain credit for tax withheld at the source in the same manner as individuals, but are not entitled to the credit of \$2,000 against net income allowed domestic corporations.

113. How may a citizen or resident of the United States obtain credit for tax withheld at the source in his behalf?

Tax withheld at the source on income of citizens or residents must be included in the taxpayer's gross income, but he may credit the amount of tax withheld against his total tax liability as disclosed by his return. Such credit may be taken although the taxpayer may be liable to surtax only.

114. How may a citizen or resident secure the benefit of personal exemption when receiving payment of interest on bonds containing a tax-free covenant clause?

By attaching to the interest coupons an ownership certificate, Form 1001, revised. If exemption is not claimed, Form 1000, revised, should be used.

115. Is a corporation required to actually deduct and withhold the tax from amounts of interest it pays on bonds which contain a tax-free covenant clause; or may it pay that interest in full and hold itself liable for payment of the tax from its own funds?

The stipulation in the bonds of a corporation whereby the tax which may be assessed against them, or the income therefrom, is guaranteed, is held not to release any party otherwise liable for the tax. The debtor corporation will be held liable for the amount of tax due whether that tax is actually deducted and withheld, or the interest paid in full and responsibility for payment of the tax assumed by the corporation.

RETURN AND PAYMENT OF TAX WITHHELD AT THE SOURCE.

116. How is tax withheld at the source to be returned and paid?

Tax withheld from income other than interest on corporate obligations should be reported to the collector for your district on Form 1042, revised, accompanied by certificate 1098, revised, covering each item in the return, on or before March 1 of the year next succeeding the year during which the withholding occurred. Tax withheld from interest on corporate obligations should be reported to the collector on Form 1012, revised, within 20 days after the close of the month

during which the withholding occurred, and summary of such monthly returns shall be made to the collector on or before March 1 of each year on Form 1013, revised.

Payment of tax assessed against a withholding return should be made to the collector in whose district the withholding agent is located and with whom the withholding return is filed. Such payment is to be made on or before June 15 of the year in which the withholding return is required to be filed.

117. If a withholding agent fails to make and file return or pay any tax due, is he subject to any penalties?

Failure to make and file withholding returns on or before the prescribed due dates renders a withholding agent liable to an additional penalty of 25 per cent of the amount of the tax required to be withheld and a specific penalty not exceeding \$1,000; except that if the tax required to be withheld is paid by the recipient of the income, no penalty shall be imposed upon the withholding agent unless his delinquency was fraudulent and for the purpose of evading payment. Any withholding agent willfully attempting to defeat or evade the tax, or who willfully refuses to withhold or pay the tax or make a return, will be liable to a penalty of 50 per cent of the amount of the tax evaded and a fine not exceeding \$10,000, or imprisonment for not more than one year, or both, together with the costs of prosecution.

RETURNS OF INFORMATION.

118. From whom are returns of information required?

All individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another individual, partnership, personal service corporation, or fiduciary, of fixed or determinable income (other than payments described in sections 254 and 255 of the Act) of \$1,000 or more in any taxable year, shall render an annual return, under oath, setting forth the amount of such income and the name and address of the recipient. A return of information is required to be filed by a fiduciary showing the distributive share of each beneficiary, and by partnerships and personal service corporations showing the distributive shares of their members, irrespective of amount and whether or not actually distributed. In the case of payments of interest upon bonds and similar obligations of domestic or resident foreign corporations and in the case of interest upon bonds of foreign countries or nonresident foreign corporations or dividends upon stock of nonresident foreign corporations the original ownership certificates, when duly filed, shall constitute and be treated as returns of information. Where a foreign corporation or foreign government issues bonds and has no paying agent in the United States, the last bank or collecting agent undertaking the collection of interest on such obligations should render the return of information, and in the case of dividends the first bank or collecting agent is the source of information.

Where the tax has been withheld from interest payments on corporate bonds and from fixed or determinable income paid to nonresident aliens, a return of information is not required, as the

withholding agent's return of tax withheld at the source is treated as a return of information.

119. Upon what forms are returns of information required to be rendered, and with whom are such returns to be filed?

Returns of information as to payments of \$1,000 or more in any taxable year should be made on Form 1099, revised, and filed with the Commissioner of Internal Revenue on or before March 15 of each year, accompanied by a letter of transmittal, under oath, on Form 1096, revised. A monthly return of payments of interest on bonds of domestic and foreign corporations and countries and dividends on stock of foreign corporations should be made on Form 1096-A and filed with the Commissioner on or before the 20th day of the month succeeding that for which made. An annual return giving a summarization of such monthly returns is required to be filed with the Commissioner on Form 1096-B, revised, on or before March 15 of the year following that for which the return is made.

120. Where a person receives a cash compensation for services rendered, and in addition thereto commissions, living expenses, or other allowances, is the aggregate amount of cash plus the value to such person of the allowance to be returned?

Yes; a return is required in each case where the cash compensation plus the value of the allowances equals or exceeds \$1,000 for the taxable year.

PAYMENT, ABATEMENT, AND REFUND OF TAX ASSESSED.

121. To whom is an assessment of income tax to be paid?

To the collector of internal revenue with whom your return is filed.

122. When does payment of income tax assessed on individuals become due and payable?

The tax may be paid in full at the time of filing the return on or before the date upon which it is required to be filed or in four installments, each consisting of one-fourth of the total amount of the tax. The first installment should be paid at the time fixed by law for filing the return, the second installment on the 15th day of the third month, the third installment on the 15th day of the sixth month, and the fourth installment on the 15th day of the ninth month, after the time fixed by law for filing the return. Where an extension of time for filing a return is granted, the time for payment of the first installment is to be postponed until the date of the expiration of the period of the extension, but the time for payment of the other installments is not to be postponed unless the Commissioner so provides in granting the extension. However, in any case in which the time for the payment of any installment is, at the request of the taxpayer, postponed because of an extension of time for filing the return, there is to be added as part of such installment, interest thereon at the rate of one-half of 1 per cent per month from the time it would have been due had no extension been granted until paid. If any installment is not paid when due, the whole amount of the tax unpaid becomes due and payable upon notice and demand by the collector.

123. What recourse has a taxpayer under the Revenue Act of 1918 when he feels that he has been assessed income tax in excess of his true tax liability?

He may exercise his right to file with the collector for his district a claim for abatement executed on Form 47, revised, copies of which may be obtained from the collector. The filing of such a claim prior to the expiration of 10 days from date of notice and demand by the collector acts as a stay to the collection of the tax. However, in case of rejection, interest at the rate of one-half of 1 per cent per month will run from the time the amount was due until the claim is decided. The filing of a claim for abatement of tax alleged to have been erroneously assessed does not necessarily operate as a suspension of the collection of the tax. If the collector feels that the suspension of collection will jeopardize the interests of the Government, he may collect the tax and leave the taxpayer to his remedy by a claim for refund.

124. On my 1919 return I was assessed income tax in excess of my true tax liability and same was paid. How may I secure a refund?

By filing with the collector a properly executed claim for refund on Form 46, revised, copies of which may be obtained from the collector for your district.

125. How may a taxpayer secure credit for taxes erroneously collected?

A taxpayer desiring to obtain credit against unpaid assessments, for taxes erroneously collected, should file with the collector for the district in which his original return was filed a claim on Form 47-A, which claim will act as a stay to the collection of the unpaid assessment. (See art. 1034, Regulations 45.)

PENALTIES.

126. Will failure to file my return within the time prescribed by law render me liable to any penalty?

Yes; if filed on a calendar year basis and you fail to file your 1920 return in the office of the collector for your district before the close of business on March 15, 1921 (provided, of course, that an extension has not been secured), you will be liable to an ad valorem penalty of 25 per cent of the amount of the tax and a specific penalty of not more than \$1,000. When your return is made on a fiscal year basis, it should be filed on or before the 15th day of the third month following the close of the fiscal year.

127. If I fail to pay my tax or any installment thereof on or before the prescribed due date, what penalties will I be liable to?

If any tax or installment thereof remains unpaid after the date when it is due, and for ten days after notice and demand, there will be added a penalty of 5 per cent of the amount of the tax due, plus interest at the rate of 1 per cent per month from the original due date, and the offender will also be liable to a specific penalty of not more than \$1,000. The instructions on the return serve as notice and demand for payment of the first installment, and if any installment is not paid when due, the whole amount of the tax becomes due and payable upon notice and demand. Estates of insane, deceased, or insolvent persons are not liable to penalties for delay in payment of tax.

128. If I am negligent in making my return and understate the amount of tax due, what penalties will I be liable to?

Where an understatement of tax is found to be due to negligence on the part of the taxpayer, but without intent to defraud, there will be added a penalty of 5 per cent of the total amount of the deficiency and interest at the rate of 1 per cent per month on the amount of the deficiency of each installment from the time it was due.

129. What would happen should a taxpayer render a false or fraudulent return with intent to evade payment of a proper amount of tax?

He would be liable to a penalty of 50 per cent of the amount of the total understatement and a fine of not more than \$10,000 or one year's imprisonment, or both, and the costs of the prosecution.

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